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No. 88-1604

In the Supreme Court of the United States

OCTOBER TERM, 1988

JUDITH DIANE DUFF LEACH, ET AL., PETITIONERS

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether shareholders of a failed bank have standing to assert direct claims under provisions of the National Bank Act, 12 U.S.C. 93(a), or the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. 1964(c), in the absence of an allegation of injury distinct from that suffered by the bank itself.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A15) is reported at 860 F.2d 1266. The opinion of the district court (Pet. App. A17-A20) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on December 2, 1988. A petition for rehearing was denied on January 3, 1989 (Pet. App. A16). The petition for a writ of certiorari was filed on March 31, 1989. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioners are individual shareholders of the former Seminole State National Bank (the Bank). On March 16, 1984, the Comptroller of the Currency declared the Bank

insolvent and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. Nearly two years later, on March 14, 1986, petitioners filed this suit in the United States District Court for the Northern District of Texas against the Bank, its former directors and officers, MBank Dallas, and First West Financial Ventures. The FDIC entered its appearance in the district court in its capacity as receiver of the Bank. See Pet. App. A3-A4.[1]

Petitioners' first amended complaint alleged that the Bank's officers and directors engaged in various forms of mismanagement, and it asserted claims for relief under provisions of the National Bank Act, 12 U.S.C. 93(a), the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. 1964(c), and pendent state law claims. See Pet. App. A24-A44. Petitioners alleged damages in the amount of $180,000 based solely upon a loss of value of their shares of the Bank's stock. See *id.* at A41.

The FDIC and the other defendants moved to dismiss the complaint pursuant to Fed. R. Civ. P. 12(b)(6). The FDIC explained that the Bank itself possessed the right to sue its officers and directors for mismanagement, that the FDIC, as receiver for the Bank, was already pursuing such an action, and that petitioners lacked standing to commence a separate shareholder action based on an alleged injury that was indistinct from that suffered by the bank itself. The district court agreed and dismissed the action. See Pet. App. A17-A20.

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[1] The Comptroller of the Currency has since declared MBank Dallas insolvent and has appointed the FDIC as receiver of that institution as well. The FDIC, as receiver for MBank Dallas, represents that institution's interests in this litigation.

The court of appeals affirmed the district court's judgment of dismissal (Pet. App. A1-A15). The court first rejected petitioners' argument that they had standing to assert a claim under the National Bank Act (*id.* at A5-A12). The court explained that Congress enacted that statute against the background of existing commercial law, which generally required a shareholder to make a demand on the corporation to initiate its own suit based on mismanagement that injured the corporation (*id.* at A5-A10). The National Bank Act followed that established principle and gave a shareholder a cause of action only if the bank itself refused to bring suit or the shareholder had some personal injury distinct from the bank's own injury as manifested in the decline in value of the bank's stock. The court of appeals observed that dismissal was consistent with this Court's decision in *Chesbrough* v. *Woodworth*, 244 U.S. 72 (1917), and with various federal and state court decisions (Pet. App. A10-A12). The court of appeals next rejected petitioners' contention that they had standing to assert claims under RICO (*id.* at A13-A14). The Court held that RICO, like the National Bank Act, does not confer standing upon a shareholder who fails to allege any injury other than the bank's injury in the decline in value of the bank's stock (*ibid.*).

ARGUMENT

The court of appeals' decision is correct and does not conflict with any decision of this Court or another court of appeals. Accordingly further review is not warranted.

1. The court of appeals correctly held that petitioners, as minority shareholders of a failed national

bank, cannot bring suit under the National Bank Act against the bank directors and officers for mismanagement that has injured the bank itself but has not resulted in any distinct injury to the individual shareholders. The court recognized that the National Bank Act's provision holding bank officers and directors liable for violations of the Act (12 U.S.C. 93(a)) enables the *bank* to bring such suits. Since the FDIC, as receiver for the bank, is presently pursuing such an action, petitioners may not commence a "derivative" action on the bank's behalf. See Pet. App. A5-A12.

As petitioners concede (Pet. 4), the general rule in the United States is that "a stockholder of a corporation has no personal or individual right of action against third persons for damages that result indirectly to the stockholder because of an injury to the corporation." *Twohy* v. *First National Bank*, 758 F.2d 1185, 1194 (7th Cir. 1985). See generally 12B W. Fletcher, *Cyclopedia of the Law of Private Corporations* § 5911 (rev. perm. ed. 1984). "A stockholder cannot, as an individual as distinguished from a representative of the corporation, sue directors or other corporate officers for mismanagement, negligence or the like, on a cause of action which belongs to the corporation." 12B W. Fletcher, *supra*, § 5924, at 463. See, *e.g.*, *Cowin* v. *Bresler*, 741 F.2d 410, 414 & n.6 (D.C. Cir. 1984). The shareholder may bring a derivative action; but his "right to sue arises from the fact that the corporation itself refuses to sue." 13 W. Fletcher, *supra*, § 5954; see also *id.* § 5963. The court of appeals correctly concluded that these hornbook principles apply equally to federally chartered banks and preclude petitioners' suit. Accord *Gaff* v. *FDIC*, 814 F.2d 311 (6th Cir. 1987).

Petitioners contend that this Court's decision in *Chesbrough* v. *Woodworth*, 244 U.S. 72 (1917), "permitted a direct action based upon facts similar to those herein" (Pet. 6). But as the court of appeals correctly recognized, that case is clearly distinguishable. In *Chesbrough*, the plaintiffs brought an action under the National Bank Act against bank directors who had made false financial reports that had induced the plaintiffs to purchase the bank's worthless stock. See 244 U.S. at 74, 76. Thus, that suit involved a direct, individual injury rather than a derivative claim. "The bank suffered no damage. The injury created by the purchase of worthless stock was personal to the plaintiff." Pet. App. A10. See *Chesbrough*, 244 U.S. at 77.

Petitioners also contend (Pet. 6-7) that the court of appeals' decision conflicts with the Ninth Circuit's decision in *Harmsen* v. *Smith*, 542 F.2d 496 (1976), on remand, 693 F.2d 932 (1982), cert. denied, 464 U.S. 822 (1983). But as the court of appeals observed, that case is distinguishable on the same basis as *Chesbrough*. In *Harmsen*, minority shareholders brought class actions against the former directors of a failed bank, alleging—among other things—violations of the National Bank Act. The district court allowed the FDIC to intervene, but refused to substitute the FDIC as the plaintiff in the class actions, and permitted an interlocutory appeal challenging the shareholders' "right to maintain an individual and representative action" (542 F.2d at 498). The Ninth Circuit held that the minority shareholders were entitled "to maintain an individual action" (*id.* at 498-499), noting that "*Chesbrough* requires that any recovery by a minority shareholder against the defendant directors pursuant to Section 93 be limited to

such sums as will compensate such shareholder for an injury which he, as distinct from the bank, has suffered" (*id.* at 500). Thus, *Harmsen* recognized that only members of the plaintiff class whose injuries were distinct from the bank's injuries would have standing to sue. The Ninth Circuit's reasoning accordingly is consistent with the court of appeals' decision in this case.[2]

2. The court of appeals also was correct in concluding that RICO's civil liability provision (18 U.S.C. 1964(c)), like the National Bank Act provision discussed above, does not permit shareholders to bring suits based on officer mismanagement where the allegations of injury are indistinct from those suffered by the corporate entity. The court of appeals had reached that result in a previous case. See *Crocker* v. *FDIC*, 826 F.2d 347, 349 (5th Cir. 1987), cert. denied, 108 S. Ct. 1075 (1988); see also *Adams-Lundy* v. *Ass'n of Professional Flight Attendants*, 844 F.2d 245, 250 (5th Cir. 1988). The other courts of appeals that have addressed the issue have reached the same result. *Roeder* v. *Alpha Indus., Inc.*, 814 F.2d 22, 29-30 (1st Cir. 1987); *Rand* v. *Anaconda-Ericsson, Inc.*, 794 F.2d 843, 849 (2d Cir.), cert. denied, 479 U.S. 987

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[2] The Ninth Circuit also stated that the *Harmsen* complaint partially satisfied *Chesbrough*'s requirements, even though some of the claims were based on the diminished value of the bank's stock. See 542 F.2d at 502. The court apparently believed, based on its reading of that particular complaint, that some of the shareholders may have suffered some "distinct" direct injury comparable to that encountered in *Chesbrough*. The court's statement, which reflected the court's construction of a particular complaint, obviously does not control the interpretation of other complaints and therefore cannot create a conflict among the courts of appeals.

(1986); *Warren* v. *Manufacturers National Bank*, 759 F.2d 542, 544 (6th Cir. 1985).

Petitioners argue more narrowly (Pet. 3-6) that the court of appeals should have relied on federal common law, rather than on Texas law, in determining whether, for purposes of RICO, a shareholder has been "injured in his business or property" (18 U.S.C. 1964(c)) when he alleges no injury distinct from that suffered by the corporate entity. See Pet. App. A13. That argument is misguided. As our discussion above shows, the rule is well settled—as a matter of federal *and* state law—that a shareholder does not have a legally cognizable injury in such circumstances. Indeed, as the Seventh Circuit noted, "the American rule barring shareholder damages actions arising out of corporate transactions with third parties has universal application among Western nations" (*Twohy*, 758 F.2d at 1194).[3] Thus, the result in this case would be the same under either federal or state law.

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[3] Petitioners cite (Pet. 4-5) several cases that supposedly adopt a contrary rule. See *Pepper* v. *Litton*, 308 U.S. 295 (1939); *First Hawaiian Bank* v. *Alexander*, 558 F. Supp. 1128 (D. Hawaii 1983); *Johnson* v. *American General Insurance Co.*, 296 F. Supp. 802 (D.D.C. 1969). At most, however, those cases simply acknowledge the point, made in *Chesbrough*, that a shareholder may bring an action based on direct claims for breach of a duty owed to him personally.

CONCLUSION

The petition for a writ of certiorari should be denied.
Respectfully submitted.

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